

## Professionals' View October 2011

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### Would You Prefer Hanging Or Firing Squad?

Whilst having a choice is nice, it doesn't necessarily mean that the underlying problem is solved. As the Eurozone debt crisis lurches from bad to worse, it is becoming clearer that, despite the best intentions of politicians, bankers and policy makers from all corners of the globe, the solution (if there is one) is going to be mighty unpleasant for some, possibly terminal for others. Unsurprisingly the terminal candidates are trying to make sure that it's someone other than themselves who will bite the dust.

Merryn Somerset-Webb of Moneyweek reminds us of Sherlock Holmes' insightful statement : "Once you eliminate the impossible, what is left, however improbable, must be the truth." So what is impossible? Well, we saw in 2008 that a full blown failure of the banking system was a step too far for the world to accept, and dramatic actions were taken to prevent it from happening. Decisions were taken by the hour back then. Europe shuffles along now in monthly meetings. It seems that most people accept that we are on the brink of something enormous, but not sufficiently near the edge to trigger instantaneous policymaking. Maybe a Greek default would help things along a bit more quickly.

### Contagious :

Greece has been described as the cancer of Europe. Unless the core is dealt with and eliminated, it continues to grow and spread, moving to different areas and infecting them. Where Greece led, Portugal, Ireland and Spain followed, to be joined by the biggest of them all, Italy. It is widely expected that Greece will default and if it does so then perhaps it will draw a temporary line under events for a while. Any default will hurt someone and pain is unavoidable. The question of who gets hurt the most is a matter of speculation. European banks will suffer, some more than others, and the French banks have been rumoured to be more at risk than most. How any

bank failure contagion would play out is an unknown, but at least it would soon become a known and the world could move on.

The Greek people would be hurt. The austerity measures already embarked upon would probably just be the beginning, but the conundrum facing those who call for more and more austerity don't really come up with a solution to the problem of higher taxes, and deeper cuts leading to no growth. With no growth, debt starts to balloon. The only answer is for the debts to be written off if this happens, so it's back to square one because who owns the debt? Banks. Banks with no capital equals banking crisis, and so the wheel continues to turn.

An ensuing risk would be if Greece were seen by others to have "got away with it". Greece's debt may or may not be manageable if it was not repaid in full. Italy and Spain's would not. Quite what happens in this instance is unclear.

### No One Actually Has A Valid Plan:

One of the biggest problems in dealing with the crisis is that no one actually has a single valid plan for what to do. They're all stumped. On the weekend of 24th September a conference was held in New York at which global banking chiefs, government ministers, the IMF and the ECB all met to discuss what to do. According to Bloomberg, "the level of disagreement between bankers and government officials was matched only by their shared sense that the stakes have rarely been higher." Chief Executive Officer of Morgan Stanley, James Gorman, summed up by saying, "there's no one solution. It's going to 25 different things."

One of the central planks of the conference was a proposal to increase the scope of the European Financial Stability Facility (ESFS) from its original 440 billion Euro size to an incredible 2 trillion Euros, hopefully a big enough number to warn off speculators. Markets rallied nearly 5% on the back of the news that something was being suggested.

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However, problem number one is that the first ESFS tranche that was proposed on July 21<sup>st</sup> has not yet been ratified (such is the grinding pace of European politics). Problem number 2 is that the German Finance Minister has categorically stated that the leveraged second proposal is off the agenda. And here lies the crux of the matter. Everything has to be passed by each of the 17 member states of the Eurozone. Be it Finland, Slovakia or Germany, any dissenting voice means that the whole deal falls through. And the German people are close to crying "enough".

Understandably, having successfully navigated the tricky waters of reunification over the past ten years (not without significant cost to the old West Germany) the population and the Bundesbank is far from happy at the prospect of seeing their taxes rising in order to bail out Mediterranean countries who, in their eyes, have been playing fast and loose and generally partying for years at the expense of those who have been more prudent and have cut their cloth accordingly.

### Chinese Whispers:

Italian finance minister, Guilio Tremonti, has worried in the past about "reverse colonisation" by China into Europe, voicing concerns held by others less vociferous than himself. Not so worried, it seems, as to prevent him from openly asking them for money in the form of buying their bonds. "If the Eurozone is to be rescued, Beijing may well seem the only plausible quarter to which to look for succour" says Stephen Lewis of Monument Securities. Chinese intervention would buy time for the Eurozone, and time is at a premium right now. However, it can not be expected that China simply helicopter drops cash into Europe without strings attached and it is unclear how comfortable the West would be if it was asked to give up too much in the way of sovereign assets, but can it afford to turn down a helping few billion? Having said this, China needs a functioning West as it makes a huge amount of merchandise that needs to be bought to feed the ever-expanding expectation of the more affluent Chinese population. Recent weeks have seen a tumbling

Emerging Market sector as contagion spreads far and wide. No one and nothing is immune, it seems, from the rumbling debt crisis.

### Gold Falls:

Even the safe haven that has been gold has seen a very sharp corrective movement leading some to call the bursting of the glistening bubble. We see it more as a technical price movement aligned to an increase in margin calls imposed upon holders of precious metals. The drop in prices is a reminder that values can fall sharply as well as rise, but we expect demand to pick up once more as market volatility continues.

### End In Sight?:

Is there an end in sight to the debt crisis? Not really, not from where we're looking. Of course there will be an end in one form or other and every day that passes means that we are a day closer to finding out how the whole scenario plays out. Even if Europe can somehow stabilise, it seems to be forgotten that it was but a month ago that the US was de-rated as their politicians played Russian Roulette with their debt ceiling. Let us not forget that a further round of negotiations is approaching there in the coming weeks.

All in all, this is a time to review, protect and assess one's investments like never before. Safe havens can become toxic overnight. Savings could vanish. Opportunities will arise and some will be taken, others will be missed. Always feel free to ask us if you have no one else to whom to turn.

**The value of investments can fall as well as rise and past performance is not a guide to the future. The information contained within this document is for guidance only and is not a recommendation of any investment or a financial promotion.**